88-1704

Supreme Court, U.S.
FILED
APR 18 1989
JOSEPH F. SPANIOL, JR.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

LEUCADIA, INC.,

Petitioner,

vs.

RELIANCE INSURANCE COMPANY,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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QUESTION PRESENTED

On appeal to a United States court of appeals after a jury verdict in a civil action in a United States district court, may an error in the jury instructions be held harmless, where such a holding necessarily requires the court of appeals to resolve a credibility question against the appellant?

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IN THE

SUPREME COURT OF THE UNITED STATES

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vs.

RELIANCE INSURANCE COMPANY,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Leucadia, Inc.[1] hereby petitions this Court to issue a writ of certiorari to the United States Court of Appeals for the Second Circuit.[2]

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[1] Leucadia, Inc. is a wholly-owned subsidiary of Leucadia National Corporation. Other affiliates and subsidiaries (other than wholly owned subsidiaries) of Leucadia National Corporation are PHLCORP, Inc., Brae Corporation, Empire Insurance Company and AllCity Insurance Company.

[2] The parties to the proceeding in the court of appeals for which review is sought were Leucadia, Inc., the appellant in that court, and Reliance

(Footnote continued)

OPINION BELOW

The opinion of the court of appeals (App. 1-23, *infra*), affirming the district court, is designated for official publication, but has not yet been published. The district court did not deliver an opinion in connection with the issue on appeal.

JURISDICTION

This Court's jurisdiction is invoked pursuant to 28 U.S.C. § 1254(1). The court of appeals issued its original opinion and judgment on December 22, 1988. On January 18, 1989, the court of appeals issued an order amending its opinion and denying a petition for rehearing.

CONSTITUTIONAL PROVISIONS AND STATUTES WHICH RELATE TO THE CASE

The Seventh Amendment to the United States Constitution provides:

> In Suits at common law, where the value in controversy shall exceed twenty dollars, the right of

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Insurance Company, the respondent. Edward Helmke was a third-party defendant in the district court action from which the appeal was taken. Mr. Helmke was not a party in the court of appeals.

> trial by jury shall be preserved, and no fact tried by a jury, shall be otherwise reexamined in any Court of the United States, than according to the rules of the common law.

Section 2111 of Title 28 of the United States Code provides:

> On the hearing of any appeal or writ of certiorari in any case, the court shall give judgment after an examination of the record without regard to errors or defects which do not affect the substantial rights of the parties.

STATEMENT OF THE CASE

During the period from May 1976 through October 1977, the period at issue in this action, Leucadia, Inc. ("Leucadia") was primarily involved in various kinds of commercial financing. One of its divisions was a commercial real estate mortgage department. That department engaged in making secured loans, based on second or third mortgages, to commercial real estate ventures.

Edward Helmke was the manager of Leucadia's real estate department in May 1976, and he remained in that position until September 1977, when he was discharged. Subsequent to Helmke's discharge, senior Leucadia management uncovered evidence indicating that Helmke had

been abusing his position as manager of the real estate department to make unauthorized diversions of Leucadia funds. Specifically, Leucadia discovered that Helmke had made a series of unauthorized gifts and unsecured, undocumented loans, in contravention of Leucadia's basic rules and policies, to three former Leucadia borrowers: Isaac Silverman, Wayne Duddleston and Morris Suson. Leucadia lost approximately $9 million as a result of improper diversions by Helmke to these three borrowers during the May 1976 to September 1977 period at issue.

Upon discovering Helmke's unauthorized diversions of its funds and its resulting losses, Leucadia submitted a claim for reimbursement to respondent Reliance Insurance Company ("Reliance"). Leucadia had purchased insurance coverage from Reliance, in the form of fidelity bonds, to insure against losses it sustained during the period from May 1976 through October 1977, as the result of the dishonest or fraudulent acts of Leucadia employees. Upon review of Leucadia's claim, Reliance refused to make any payments under the fidelity bonds it sold to Leucadia, asserting that Leucadia had not adequately demonstrated that its losses

resulted from dishonest acts on the part of Helmke. Leucadia ultimately instituted the action in the district court below for the purpose of recovering on the fidelity bonds.[3]

At trial, Leucadia succeeded in establishing that in several instances, Helmke had made unauthorized multi-million dollar loans in contravention of fundamental Leucadia rules. For example, it was established that, because the commercial real estate operators served by Leucadia's real estate mortgage department were generally high risk borrowers, it was imperative to Leucadia that loans to these borrowers be adequately collateralized and documented. Helmke, as manager of the department, was charged with the responsibility of seeing that the collateral and documentation requirements were followed. Yet, Helmke loaned at least $2 million of Leucadia's funds to Isaac Silverman, at a time when Silverman was already in default on prior Leucadia loans, without obtaining any collateral to secure the new loans

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[3] Subject matter jurisdiction in the district was predicated upon diversity jurisdiction, pursuant to 28 U.S.C. §1332, in that Leucadia was a Delaware corportion with a principal place of business in New York, Reliance was a Pennsylvania corporation with a principal place of business in Pennsylvania, and the amount in controversy exceeded $10,000, exclusive of interest and costs.

or any documentation to evidence Silverman's obligation to repay the loans. Similarly, Leucadia demonstrated at trial that Helmke gave Morris Suson a new loan of $2,654,050 in Leucadia's funds without obtaining any collateral to secure that loan, at a time when Suson was already in serious default on prior Leucadia loans.

It was also shown at trial that Helmke arranged for advances to certain lenders through affirmative misrepresentation. For example, Helmke misstated by over one million dollars the value of a Silverman property to his superiors at Leucadia in order to obtain approval for a loan to Silverman which would otherwise have been denied, and represented to his superiors that loans to Duddlesten would be secured by security interests in Duddlesten properties which in fact Helmke never obtained.

At the conclusion of the trial, the district court instructed the jurors that in order to render a verdict in Leucadia's favor, they must be convinced by clear and convincing evidence, beyond all substantial doubt, that Helmke had committed the dishonest acts Leucadia claimed. The jurors were not persuaded that Leucadia had discharged

this stringent burden of proof, and rendered a verdict in favor of Reliance.

On appeal, the court of appeals held that the district court's instructions on the burden of proof were erroneous, and that Leucadia should only have been held to a preponderance of the evidence burden. It affirmed the judgment, nevertheless, on the ground that the error was harmless.

The harmless error holding was premised in large part on the court of appeals' willingness to credit Helmke's trial testimony concerning his intent in distributing Leucadia funds in violation of the company's basic rules. Helmke claimed at trial that each and every one of his unauthorized diversions of Leucadia funds supposedly could be explained either as an unorthodox attempt to further Leucadia's interest or as an innocent mistake. He asserted that regardless of outward appearances, his violations of basic company policies on loan security and documentation were always either part of a purported good faith effort to serve Leucadia's ultimate best interest, or inadvertent oversights. In conducting its harmless error analysis, the court of appeals accepted Helmke's

testimony on these points as truthful. Thus, in its harmless error discussion, the court of appeals observed:

> Almost all of Helmke's decisions to advance moneys which ultimately resulted in losses *can be construed to be reasonable* under all the circumstances (A. 20).
>
> * * *
>
> In this context the loans Helmke made *may plausibly be viewed* as an attempt to keep properties afloat and to preserve the existing collateral in order to prevent difficulties for Leucadia under the credit agreement (A. 20).
>
> * * *
>
> Leucadia's other allegations of Helmke's misconduct concerning Silverman . . . although they may be violative of company policy, *can reasonably be explained* as attempts to save properties in default (A. 21).
>
> * * *
>
> [Helmke's] representation to the senior credit committee that the Seamist loan would be cross-collateralized, when, in fact, it was not, *appeared to be* an expectation which was not realized, made without any intent to deceive or defraud Leucadia (A. 22).

(Emphasis added).

The credibility of Helmke's trial testimony, however, was the most sharply disputed issue at trial. Helmke, as a third-party defendant, was an interested witness with a tremendous motive to deny that he was guilty of any

wrongdoing: a judgment against Reliance would mean a claim-over judgment by Reliance against Helmke for millions of dollars. The jurors had before them evidence of numerous inconsistent statements by Helmke on material issues, and evidence of a pattern and practice by Helmke pre-dating the period at issue of diverting Leucadia funds to third parties and concealing those diversions.

Moreover, the jurors, applying the preponderance of the evidence standard, might have found that Helmke acted with the requisite intent -- to benefit third parties at Leucadia's expense -- simply by making the inference that a person intends the natural and probable consequences of his actions. It would be quite reasonable to conclude that Leucadia's policy of requiring adequate security and documentation on high-risk loans was based on the obvious risk that such high-risk loans otherwise would be uncollectible; and that the natural and probable consequence of making unsecured and undocumented loans to high risk borrowers already in default on prior Leucadia loans would be to benefit those borrowers, at Leucadia's expense.

In view of the substantial credibility issues implicated in Helmke's testimony, the court of appeals' harmless error holding, resolving the question of Helmke's credibility against Reliance, was itself erroneous. Leucadia raised this issue in a petition for rehearing before that court. The court of appeals responded by denying the petition for rehearing, but simultaneously amending some of the language of its opinion for the stated purpose of conforming it to the harmless error standard enunciated by this Court in *Boyle v. United Technologies Corp.*, ___ U.S. ___, 108 S.Ct. 2510 (1988), which Leucadia argued controlled. The amendments in the opinion, however, did not affect any of the language quoted above, relating to the credibility of Helmke's testimony. The cornerstone of the court of appeals' harmless error holding remains its determination of Helmke's credibility against Leucadia. For that reason, the holding is erroneous, and should be reviewed in this Court.

REASON FOR GRANTING THE WRIT

A WRIT OF CERTIORARI SHOULD BE GRANTED TO CLARIFY THE HARMLESS ERROR STANDARD APPLICABLE IN CIVIL APPEALS FROM JURY VERDICTS IN THOSE ACTIONS IN WHICH THE RIGHT TO TRIAL BY JURY IS PROTECTED BY THE SEVENTH AMENDMENT.

Leucadia had the right under the Seventh Amendment of the federal constitution to a jury determination of the disputed facts underlying its claims against Reliance. It was entitled to have its case submitted to the jury unless, as a matter of law, no reasonable juror could rationally render a verdict in its favor. Direction of a verdict against it, in the face of evidence which could rationally support a favorable verdict, would constitute federal constitutional error under the Seventh Amendment. *See e.g., Helene Curtis Industries, Inc. v. Pruitt*, 385 F.2d 841, 850 (5th Cir. 1967), *cert. den.*, 391 U.S. 913 (1968); *United States v. Lesher*, 59 F.2d 53, 54 (9th Cir. 1932) ("Under the Seventh Amendment to the Constitution, a jury trial is guaranteed in a civil action; and that it is error to direct a verdict for defendant if there is any substantial evidence is stare decisis.").

In the instant case, the district court properly denied Reliance's directed verdict motions and submitted Leucadia's claims to the jury. However, as the court of appeals held, the claims were submitted with the erroneous instruction that Leucadia could not prevail unless it proved the commission of dishonest acts by clear and convincing evidence, beyond all substantial doubt. Submission of the case with this erroneous instruction was tantamount to not submitting the case to the jury at all, because Leucadia was effectively denied its right to a jury determination as to whether it had proved its claims by a preponderance of the evidence, the governing standard.

Because of the Seventh Amendment considerations presented, reversal for a new jury trial was imperative, unless the court of appeals could conclude from the record of the first trial that no reasonable jury, properly instructed, could rationally return a verdict in Leucadia's favor. *Boyle*, 108 S. Ct. at 2519; *Mandel v. Max-France, Inc.*, 704 F.2d 1205, 1207 (11th Cir. 1983) (applying this rule where the district court had erroneously instructed the jury that plaintiff's standard of proof was clear and convincing evidence, instead

of a mere preponderance, and holding that a new jury trial was mandated).

The harmless error analysis for error of the kind found here, as addressed in this Court's opinion in *Boyle*, and by the Eleventh Circuit in *Mandel*, is essentially the same as the analysis required of the district court in ruling on a directed verdict motion:

> It is well established that in ruling on a motion for a directed verdict, the trial court must determine whether the evidence, viewed in the light most favorable to the nonmoving party, is sufficient to allow a reasonable juror to arrive at a verdict in the latter's favor. [Citations omitted] In making this determination, all reasonable inferences must be drawn in favor of the nonmoving party, and all questions of credibility must likewise be decided in his favor. [Citations omitted] If, within this framework, the court concludes that the jury could not rationally find in favor of the nonmoving party, it may properly grant the motion for a directed verdict.

Konik v. Champlain Valley Physicians Hospital Medical Center, 733 F.2d 1007, 1013 (2d Cir.), *cert. den.*, 469 U.S. 884 (1984).

In its harmless error analysis in the instant case, the court of appeals failed to apply the requisite "directed verdict" analysis. Instead, the court engaged in precisely the type of factual evaluation which this Court held in *Boyle* was

prohibited. 108 S. Ct. at 2519. The court of appeals concluded that Helmke in fact on several occasions had arranged for unauthorized diversions of millions of dollars of Leucadia's funds, in contravention of fundamental Leucadia policies and rules. A. 9-10, 14. But the court went on to find that Helmke's self-serving explanations to the effect that he acted with innocent intent should be credited, thus negating the element of wrongful intent essential to a verdict in Leucadia's favor. A. 19-23.

Of all fact-finding functions which are reserved to the province of the jury, the question of the credibility of testimony bearing on a person's intent is perhaps the purest of jury questions. Thus in *Liberty National Bank v. Aetna Life & Casualty Co.*, 568 F. Supp. 860 (D.N.J. 1983), like the instant case, an action against an insurer to recover on a fidelity bond for losses caused by the dishonest acts of an employee, the court recognized that only the jury could resolve the issue of the allegedly dishonest employee's intent:

> Questions of intent, which are clearly crucial here, are normally inappropriate for summary disposition. 6 Moore's Federal Practice ¶56.17 (41.1). Intent to injure or defraud may be inferred from the fact of injury, if injury is the natural result of a voluntary act on the part of the employee. *See United States v.*

> *Schmidt*, 471 F.2d 385, 386 (3d Cir. 1972) (In criminal prosecution for misapplication of bank funds, intent to injure and defraud exists if person acts knowingly and if natural result of conduct would be to injure or defraud bank even though this may not have been person's motive).

568 F. Supp. at 868; *see also, e.g., Arlington Trust Co. v. Hawkeye-Security Ins. Co.*, 301 F. Supp. 854, 858 (E.D. Va. 1969). In *Liberty*, as in the instant case, the employee alleged to have acted dishonestly provided testimony that his challenged actions were all undertaken in good faith, with the interests of his employer at heart.[4] The plaintiff presented no direct evidence of the employee's dishonest intent; its case on that issue, as here, was circumstantial. The *Liberty* court nevertheless held that the employee's testimony disavowing any dishonest intent, far from being dispositive, required resolution by the jury. 568 F. Supp. at 868.

In the instant case, by contrast, the court of appeals rested its harmless error conclusion on a finding of the credit-worthiness of Helmke's testimony that his unauthorized

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[4] In *Liberty*, as in the instant case, the allegedly dishonest loan officer asserted "that at all times, he thought he was acting in the best interests of the Bank and in furtherance of the Bank's goal to develop its lending activities among successful business persons in the community." 568 F. Supp. at 868.

actions were all undertaken either for Leucadia's benefit or inadvertently. A judicial finding on Helmke's credibility, however, could not form the basis for a directed verdict.[5] *E.g.*, *Bhaya v. Westinghouse Electric Corp.*, 832 F.2d 258, 262 (3d Cir. 1987) ("Evaluation of witness credibility is the exclusive function of the jury, and where the only evidence of intent is oral testimony, a jury could always choose to discredit it"); *Hindman v. City of Paris, Texas*, 746 F.2d 1063, 1068 (5th Cir. 1984) ("the question of a witness's credibility is the purest of jury issues"); *Croce v. Kurnit*, 737 F.2d 229, 236-237 (2d Cir. 1984) (directed verdict improper if it requires weighing the credibility of a witness).

Just as a directed verdict based on a credibility determination by the court would be improper, a harmless error analysis which involves a credibility assessment cannot stand, pursuant to the standard enunciated by this Court in *Boyle*. In the instant case, the court of appeals' opinion makes plain that its assessment of Helmke's credibility was the

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[5] The district court in this case, having the advantage of observing the witnesses as they testified, properly denied Reliance's directed verdict motions made during the trial.

cornerstone of its harmless error conclusion. In making a credibility determination in order to reach a harmless error result, the Court denied Leucadia its constitutional right to have witness credibility determined by the jury.

A writ of certiorari should be granted to address this issue. While the standards for harmless error analysis in criminal appeals from jury verdicts are well established, under *Chapman v. California*, 386 U.S. 18 (1967) and its progeny, there is no equivalent body of law relating to civil appeals. Although this Court addressed the standard for harmless error analysis on appeals after civil jury trials in *Boyle*, that discussion was ancillary to the principal issue in *Boyle*, and the Court had no occasion there to address squarely the harmless error issue presently here: whether a substantial error affecting the conduct of a jury trial, such as erroneous instructions on plaintiff's burden of proof, may be held harmless, where a finding of harmlessness requires the resolution of credibility issues.

By its order amending its opinion for the purpose of conforming to *Boyle*, the court of appeals indicated its recognition of the general principle that directed verdict

standards should be used in conducting the harmless error analysis. By its decision not to amend the portion of its opinion regarding Helmke's credibility, however, the court of appeals has established a precedent for taking credibility questions away from the jury. This was error of a magnitude warranting review by this Court.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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ATTORNEYS FOR PETITIONER

April 1989

APPENDIX

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 1333—August Term 1987

Argued: June 3, 1988 Decided: December 22, 1988

Docket No. 88-7197

LEUCADIA, INC.,

Plaintiff-Appellant,

—against—

RELIANCE INSURANCE COMPANY,

Defendant-Third-Party Plaintiff-Appellee,

—against—

EDWARD H. HELMKE,

Third-Party Defendant.

B e f o re :

LUMBARD, MINER, *Circuit Judges*, and CONNER, *District Judge*.*

* *The Honorable William C. Conner, Senior United States District Judge for the Southern District of New York, sitting by designation.

Appeal from a judgment of the district court for the Southern District of New York, Daronco, *J.*, after a jury verdict finding that defendant insurance company's fidelity bonds did not cover plaintiff's loss. The insured claims errors in the jury charges on the period of coverage and on the evidentiary standard to be applied.

Affirmed.

RAYMOND FITZGERALD, New York, New York (Butler, Fitzgerald & Potter, New York, N.Y., Andrew W. Sidman, David J. McCarthy, of counsel), *for Plaintiff-Appellant.*

PHILIP SCHLAU, New York, New York (Newman Schlau Fitch & Burns, P.C., New York, N.Y., Abraham S. Altheim, Jan Kevin Myers, of counsel), *for Defendant-Third-Party Plaintiff Appellee.*

PERRY S. REICH, Lindenhurst, N.Y. (Schapiro and Reich, Lindenhurst, N.Y., Steven M. Schapiro, of counsel), *for Third-Party Defendant.*

LUMBARD, *Circuit Judge*:

Leucadia, Inc. appeals from a judgment of the Southern District entered on February 5, 1988, Daronco, *J.*, pursuant to a jury verdict in favor of Reliance Insurance Company and third-party defendant Edward H. Helmke.

Leucadia, which is in the business of factoring and investing, brought this action to recover $10 million pursuant to two fidelity bonds issued to it by Reliance, because of losses totaling over $15 million, allegedly sustained as a result of the dishonest and fraudulent acts of its employee Helmke while he was head of Leucadia's mortgage loan department. Reliance impleaded Helmke as third-party defendant for indemnification. Jurisdiction is based on diversity of citizenship, as Leucadia is a New York corporation, and Reliance is a Pennsylvania company. The parties agree that New York law applies.

Leucadia makes two principal claims. First, it asserts that the district court erroneously instructed the jury that Reliance was liable only for those fraudulent and dishonest acts committed during the period the bonds were in force, namely from May 1, 1976 to October 25, 1977. Leucadia alleges that the second bond covered all losses sustained while the bond was effective, regardless of when the acts that caused the losses had been committed. Leucadia also asserts that it was error for the judge to rule that any evidence of alleged misconduct occurring prior to the effective date of the first bond could be considered by the jury only to show intent to commit similar acts within the coverage period.

Second, Leucadia claims that the district court erred in instructing the jury that Leucadia was required to prove that Helmke had acted dishonestly by clear and convincing evidence. It alleges that, because the fidelity bonds covered both fraud and dishonesty, the court should have charged that there were different burdens of proof for fraud and dishonesty. Only a preponderance of the evidence is necessary to prove acts of dishonesty under New York law.

We hold that the district court correctly limited the coverage of the bonds to acts committed within their duration and that therefore it was proper to admit evidence of prior alleged misconduct only for the purpose of showing Helmke's intent. On Leucadia's second claim, we find that, because the fidelity bonds insured against either a "dishonest or fraudulent act," under New York law the court should have instructed the jury to employ separate evidentiary standards for proving fraud and for proving dishonesty. Judge Daronco correctly charged the jury that, in order to find that Leucadia's losses had resulted from fraudulent acts, it must find that the evidence of fraud was clear and convincing. However, he should also have instructed the jury that, in deciding whether any of Leucadia's losses had resulted from Helmke's dishonest acts, they would only have had to find that this was established by a preponderance of the evidence.

Although it was error for the court to charge the jury that there was a higher standard for dishonesty, our review of the evidence convinces us beyond a reasonable doubt that the jury would nevertheless have found that Leucadia had failed to establish Helmke's dishonesty by a preponderance of the evidence. In view of the evidence, the court's error was therefore harmless.

In May 1976, Leucadia purchased a fidelity bond (the May bond) under which Reliance agreed to indemnify it for up to $2 million in losses resulting from dishonest or fraudulent acts of an employee committed from May 1, 1976 through the bond period. On December 1, 1976, Leucadia cancelled the May bond and replaced it with a second fidelity bond (the December bond) to cover similar losses, this time up to $5 million, sustained from December 1, 1976 through its cancellation in October 26, 1977.

The December bond provided continuing coverage for losses that would have been recoverable under the May bond but which were only sustained and discovered during the December bond's term.

Both fidelity bonds stipulated that for a loss to be covered, it must have been the "direct result" of a "dishonest or fraudulent act" of an employee or agent. As defined in a rider to both bonds, a "dishonest or fraudulent act" means:

> only dishonest or fraudulent acts committed by [an] Employee with the manifest intent:
>
> (a) to cause the Insured to sustain [a] loss; and
>
> (b) to obtain financial benefit for the Employee or for any other person or organization intended by the Employee to receive such benefit . . . .

In October 1978, Leucadia discovered that it had suffered losses allegedly within the coverage of the fidelity bonds. It believed that Helmke had fraudulently and dishonestly loaned millions of dollars of Leucadia's money to three borrowers, Isaac Silverman, Wayne Duddlesten and Morris Suson, and it demanded that Reliance pay it $10 million pursuant to the fidelity bonds. Reliance refused and Leucadia brought suit.

The evidence adduced at the four-week trial which concluded on January 29, 1988 showed the following. Helmke began his employment with James Talcott, Inc., Leucadia's predecessor in interest, on March 25, 1963 as assistant in-house counsel in the legal department. On March 1, 1965, he became an assistant secretary in the company's mortgage loan department where his duties were to process and supervise loans. In August 1967, he was pro-

moted to assistant vice president of the mortgage loan department, in which he processed and supervised loans. On April 15, 1972, Helmke was promoted to vice president and manager of the mortgage loan department, where he remained until his termination on September 1, 1977.

As manager of the five-man mortgage loan department, which was engaged in making speculative investments involving real estate, investment trusts, and second and third mortgage loans, Helmke was responsible for overseeing all the accounts, for insuring that Leucadia received sufficient collateral on new loans and for protecting existing collateral on loans that were in default. In this position, Helmke reported directly to the president.

Prior to February 1, 1977, Helmke had the power to advance up to $350,000 in new investments. To effect a loan, someone in the mortgage loan department (usually Helmke) had to fill out and initial an advance card reflecting the amount of the loan. The card was then forwarded to the cashier's department, from which the money was paid out. After February 1977, Helmke's authority was reduced to $1,000 and he was additionally required to obtain the approval of Leucadia's senior credit committee, which based its decisions largely on internal memos, quarterly status reports, monthly statements of delinquent accounts, and computer credit worthiness analyses that Helmke provided.

In mid-October 1977, two weeks after his termination on September 1, 1977, Helmke became director and president of a company controlled by Silverman's son-in-law, Marvin Shafron, who had assisted Silverman during the period when Helmke, as head of the department, had loaned Silverman money.

The facts concerning Helmke's dealings with the three borrowers, Silverman, Duddlesten and Suson, are as follows:

The Silverman Transactions

Isaac Silverman, a client of Leucadia's since the 1960s, used most of his borrowed funds to operate the Grand White Realty Corporation, a New York company he owned. Grand White owned seven properties in New York on which Leucadia had second and third mortgages as security for its loans. Silverman also gave Leucadia a personal guaranty on the loans. The Grand White loan, the subject of a "consolidation extension agreement" in 1970, was scheduled to be repaid in August 1973, one year into Helmke's tenure as head of the mortgage loan department. By then the debt was in default for over $6 million.

In the summer of 1973, Helmke entered into a second consolidation and extension agreement with Silverman which postponed repayment to January 1975. At about the same time, Helmke caused Leucadia to foreclose upon one of the seven properties securing the Grand White loans and reduced the oustanding debt accordingly.

Later in 1973, Helmke returned one of Silverman's personal guaranties. At trial he explained that this guaranty meant nothing to Leucadia because its policy was never to collect personal guaranties and, in any event, it had other Silverman guaranties on file; the return of this one guaranty, he said, was necessary in order to negotiate certain terms of a loan agreement with Silverman.

From 1972 to 1976, as a result of a decline in the real estate market, the properties that collateralized the Grand White loan became less marketable. In a status report to his superiors in 1976, Helmke stated that the net appraised

total value of the collateral was $10,984,828 (arrived at after deducting the amount of the prior mortgages to cover the Leucadia mortgage), in contrast to its 1972 appraised value of $21,200,000.

Leucadia claims that in this report Helmke overrepresented the value of one of the properties by $1,350,000 to $2,000,000. Helmke cited its appraised value at $7,780,000 when it had only been appraised from $5,800,000 to $6,500,000. Helmke testified that he had not prepared the figures for this property, which had been reappraised several times, and that he had believed them to be an accurate measure of "intrinsic", even if not "appraised", value. He said that he believed intrinsic value was a more useful criterion by which to determine how much money to advance, because the market was artificially low at that point.

In the summer of 1973, Leucadia convinced Silverman to settle a lawsuit involving rent and overtime claims against IBM, the sole tenant of a group of office buildings in White Plains, New York, one of the properties securing the Grand White loans. Silverman had assigned the rent received from IBM to Leucadia, which therefore had an interest in retaining IBM as a tenant. Silverman agreed to drop his lawsuit and settle with IBM; Leucadia received $1,641,008 of the proceeds, which totaled $1,951,008, and Silverman got the remaining $310,000 of the proceeds in addition to two new advances, one of $80,000 (the "Sealist loan" in Manhattan) and one of $40,000 (the "Madimore loan" in Florida).

At the time of this White Plains arrangement, Helmke did not fully inform the senior credit committee about the $310,000 Silverman was to realize in the deal. He did not run the check for $310,000 through Leucadia's books.

Helmke testified that his instructions were to obtain a settlement and, given the pressure of the situation, he believed that $310,000 was a small price to pay to induce a settlement which was highly beneficial to Leucadia.

The two loans Helmke made to Silverman were collateralized and approved by his superiors. For the Madimore loan Helmke secured an assignment of a contract. He secured the Sealist loan by a personal guaranty and an unrecorded mortgage. In May 1976, although the Sealist loan had been in default since January 1975, Helmke advanced an additional $10,000 on the Sealist account. Helmke testified that he was trying to enhance the collateral and tide the property over until better times. The loan was eventually repaid in full after Helmke's termination in 1977.

Thomas Mara, a vice president at Leucadia since April 1977, testified that from May 1976 to September 1977, Helmke made loans totaling $4,340,170.05 to Silverman. Of this, $2 million was for the renovation of 315 Park Avenue South in Manhattan, one of Silverman's failing properties that collateralized the Grand White loans. The renovations were made in accordance with a lease entered into in September 1975 between Silverman and the Optometry School of the State University of New York.

Leucadia asserts that Helmke poured money into this renovation, despite Silverman's long-standing default on the loan. Approximately $4 million in principal was outstanding on the first mortgage on 315 Park Avenue South as of January 1, 1976; and the building's equity was already encumbered by a second mortgage and was part of Leucadia's security for its loan of approximately $10 million to Grand White. Although Silverman personally guaranteed this loan, Helmke did not obtain a promissory note

or mortgage for these renovation loans. He testified that he was simply following the same procedure he used for all advances made on the Grand White account. Furthermore, company policy was geared to enhancing the value of collateral rather than to writing off loans.

Leucadia's claim that Helmke was responsible for overpaying the renovation company for poor work is not supported by the evidence.

The Duddlesten Transactions

With regard to the Duddlesten loans, Leucadia claims it sustained losses of $2,284,575.87 during the bond period as a result of Helmke's dishonest and fraudulent acts of advancing money to the Seamist Corporation, a company controlled by Duddlesten. Leucadia contends that Helmke, between 1974 to 1976 (prior to the bond period), improperly advanced money on a credit line he had established for Seamist. These loans were secured by collateral which included a third mortgage on certain Seamist properties and Duddlesten's personal guaranty. The complaint alleges that Helmke during the bond period (i) failed to obtain collateral which he represented to the senior credit committee that he would secure; and (ii) knowingly accepted a worthless deed in exchange for releasing Duddlesten from Duddlesten's personal guaranties on the Seamist loans, even though Seamist and Duddlesten together owed Leucadia over $2 million. Leucadia also claims that it sustained losses of $173,800 during the bond period as a result of Helmke's simultaneous retention of two managers, Edmund Boylan and Duddlesten himself, to manage Main 2016, a building in Houston, Texas.

In December 1974, Helmke advanced $1.2 million to Seamist, secured by Duddlesten's personal guaranty, his

promissory note, and a deed of trust, under which title to 708 acres owned by Seamist in Fort Bend County, Texas was to be held in trust pending satisfaction of the loan. On February 4, 1975 an additional $365,000 was advanced by Helmke and similarly secured. All these loans were made with the knowledge and approval of Leucadia's senior credit committee. At one point, Helmke advised the committee that the Seamist loan would be cross-collateralized. In fact, it never was collaterized. Helmke testified that he had tried unsuccessfully to obtain the cross-collateralization.

The Seamist loans were unpaid at the time of their maturity in January 1976. In the late summer of 1976, in order to settle this debt, Helmke agreed to release Duddlesten's personal guaranties in exchange for a deed to the 708 acres owned by Seamist on which Leucadia already had a third mortgage.

Helmke testified that Duddlesten's personal guaranty was worthless to Leucadia and that Duddlesten had made several claims against Leucadia at the time, including a usury claim and the right to file a lien on Main 2016, which Leucadia wanted to sell. As already stated, although the firm often took personal guaranties from borrowers, it never attempted to collect on personal guaranties.

Helmke testified that, in light of the difficulties Leucadia had experienced concerning Texas usury law, it was prudent to return Duddlesten's personal guaranty, in trying to negotiate a settlement and thus avoid the loss of all the loans to Seamist. Helmke said that the 708 acres were originally worth several million dollars but that poor real estate market conditions in Texas during the late 1970s made it difficult for Leucadia to recoup its losses by selling the land. Other Leucadia executives also attested to the

depressed Texas market at that time. In any event, in January 1978 the second mortgagee foreclosed its mortgage on 635 acres of the 708.8 acres of property, leaving Leucadia with 73.8 acres still subject to the first mortgage. Finally, in July of 1978, Leucadia sold its interest in the 73.8 acres, subject to the first mortgage, to the second mortgagee for $102,456.86.

Leucadia obtained title to Main 2016, a building originally owned by Duddlesten's Seamist Corporation, by foreclosing its second mortgage on the property on April 4, 1972. In January 1973, Helmke hired Duddlesten to manage Main 2016 and also granted him an option to purchase it. In 1976-77, Duddlesten threatened to exercise his option and file a lien on Main 2016. This would have clouded Leucadia's title and prevented it from selling the land, as it was eager to do. However, as a result of Helmke's deal with Duddlesten, Duddlesten did not file a lien. Leucadia later sold the property.

From January 1973 to May 1976, Leucadia was paying both Duddlesten and Edmund Boylan to manage Main 2016. Boylan had originally been employed by Leucadia in August 1972 and Duddlesten was hired to help him in January 1973. At the time, Thomas Mara considered Boylan incompetent and inexperienced. Helmke testified that Boylan needed experienced help from somebody like Duddlesten. In any event, Leucadia's management knew about the overlap; Mara eventually fired Boylan in late 1977.

The Suson Transactions

With respect to the Suson loans, Leucadia alleges it sustained losses of $2,485,555.35 during the bond period as a result of Helmke's dishonest and fraudulent advances to

Suson and his interests. Leucadia claims that Helmke made loans (1) without authority; (2) without any collateral to secure their repayment; (3) knowing that Suson had committed certain improprieties which had adversely affected the collateral securing the loans; and (4) continued to make advances even though Suson and the entities he controlled were substantially in arrears.

Helmke first became involved in the Suson accounts in April 1972, when Leucadia advanced a total of $3,600,000 over several months to Suson to be repaid in April 1974. These loans were secured by second and third mortgages on properties among which were the Kingston Apartments and the Dempster Plaza Shopping Center, both located near Chicago.

Between April 1974 and 1975, Helmke advanced an additional sum of about $1,565,000 to Suson's trusts. Helmke represented to the senior credit committee that the collateral for the loan would be a blanket third mortgage on certain properties and a "secondary position" on another shopping center then under construction in the Chicago area.

Helmke secured all the collateral he said he would obtain, with the exception of the secondary position on the shopping center, for which he instead obtained an assignment of Suson's beneficial interest in the trusts which covered this property.

Of this $1,565,000 loan, $279,075 was used to pay interest arrearages and build a credit balance from which future interest payments would be made on certain of Suson's other loans with Leucadia. A further $231,550.24 was used to pay interest arrearages on the $3,600,000 loan. Thomas Mara testified that it was an accepted practice at Leucadia to use money for this purpose. The rest of the

loan was used to expedite the completion of the shopping center and the renovation of the Kingston apartment units under construction. These uses had the full approval of the senior credit committee.

From October 13, 1976 to May 25, 1977, Helmke loaned Suson an additional $3,554,050. Of this amount, $900,000 provided Suson with the funds to purchase, at a discount, an office building and the shopping center under construction. $300,000 of this $3,554,050 was advanced to pay for a prior commitment and was secured by a mortgage. Although Leucadia claims there was no collateral for the $900,000, Helmke testified that he secured a promissory note in the amount of $600,000, an assignment of a beneficial interest, and an assignment of option rights.

By October 13, 1976, Suson was about $1,700,000 in default on interest payments to Leucadia. Helmke nevertheless loaned him an additional $2,654,050 to renovate the Kingston Apartments without obtaining an additional mortgage. Helmke testified that he had an agreement with Suson that they would also be covered by Leucadia's existing mortgage on the Kingston Apartments. Both Franklin Johnson, a member of the senior credit committee, and John Kingston, Leucadia's president, knew of these advances. Moreover, in 1977, Kingston instituted a special credit review committee to receive detailed reports on bad accounts, of which Suson was one.

In late 1976, Helmke suspected that Suson may have forged his signature on certain documents pertaining to Leucadia's collateral on Suson properties. He contacted Elihu Fier, a lawyer whom Leucadia had retained on various matters, and asked him to investigate the question of Suson's forgery.

In mid-1977 it was discovered that Suson had in fact forged releases of Leucadia's security instruments in various properties, including the Kingston Apartments. Thomas Mara testified that after Helmke's termination, Leucadia asserted claims against Chicago Title, the company that had insured Leucadia and another lender, also a creditor of Suson, who had made additional loans to Suson in reliance on the forged release of Leucadia's security interests. The other lender also asserted claims against Chicago Title and a lawsuit ensued. A settlement was eventually reached whereby Chicago Title paid $8,150,000 to Leucadia and released the second mortgage on the Dempster Plaza Shopping Center, on which Leucadia thereafter recovered $1,000,000 after foreclosure.

The Jury Charge

Judge Daronco instructed the jury that Reliance was liable only for those of Helmke's acts of alleged fraud or dishonesty that occurred during the bond period, that is, from May 1, 1976 until October 25, 1977. He also charged that the evidence of alleged misconduct occurring prior to the commencement of the bond period was admitted for the limited purpose of showing Helmke's intent to commit similar acts during the coverage period.

The judge further instructed the jury that Leucadia bore "the burden of proving by clear and convincing evidence that an act committed by Edward Helmke was dishonest or fraudulent." He stated that this standard is "more exacting" than proof by a preponderance of the evidence in that the former should leave "no substantial doubt" in the jury's mind, while the latter required only that Leucadia's claim is more likely true than not true. Leucadia, having requested that the jury be charged with the lower standard, took exception to this charge.

Judge Daronco supplied the jury with typewritten copies of his charge and prepared a verdict form containing three special interrogatories. The jury's verdict was for Reliance on the claim between Reliance and Leucadia and, therefore, necessarily in favor of Helmke on the claim between Reliance and Helmke. The jury answered only one of the special interrogatories, responding that Helmke did not commit any "dishonest or fraudulent acts with the manifest intent to cause Talcott to sustain a loss and to obtain financial benefit for himself or for any other person or organization intended by him to receive such benefit" during the period of coverage of the bonds. Thus the jury never reached the two remaining special interrogatories regarding the computation of damages.

The Period of Liability

Leucadia claims that while the May bond specifically insured against losses resulting solely from "acts committed" during the bond period, the language of the December bond provided indemnification for "losses sustained" during the bond period—without specifying when those acts must have been committed. Leucadia alleges that from this omission in the December bond it should be inferred that the acts could have been committed at any time so long as the losses were sustained during the bond period. Judge Daronco ruled that, although the wording of the bonds differed, Reliance's intention was the same, namely, to insure for acts occurring only during the bond period (May 1, 1976 to October 25, 1977). Any other reading would require a fidelity bond company to assume responsibility for acts committed prior to the coverage period of which it could have had no knowledge.

Consequently, the court ruled that any evidence of Helmke's dishonesty regarding particular borrowers prior

to the bond period would be admitted only to show "fraudulent intent on the part of Helmke" to commit similar dishonest acts within the bond period (*i.e.*, to show lack of mistake).

We find no error in the district court's ruling that Reliance was liable only for those fraudulent and dishonest acts committed during the period the bonds were in force, May 1, 1976 to October 25, 1977. As Judge Daronco noted, allowing an insured to recover for acts committed before the period of insurance began, when the loss did not occur until the covered period, would strain the language of the bond instrument. It would make the insurance company responsible for acts which occurred before the loss was realized and of which it could have no knowledge.

It is well established that, "[i]n the absence of a clearly expressed contrary intent, fidelity guaranty contracts have prospective operation only, and they do not cover defaults occurring prior to the date when such contracts became effective," 13 Couch on Insurance 2d, § 46:176 at 137 (Rev. ed. 1982) (footnotes omitted). Thus, the December bond, with its absence of language specifying the time frame during which acts must have been committed, is presumed to have prospective operation only. *Van Schaick v. American Surety Co.*, 252 App. Div. 489, 299 N.Y.S. 908 (1st Dep't 1937), *motion for leave to appeal denied*, 277 N.Y. 740 (1938).

The Standard of Proof

The third allegedly erroneous ruling occurred when Judge Daronco, not distinguishing between the terms dishonesty and fraud in the bonds, instructed the jury that

Leucadia had to prove that Helmke's acts were dishonest or fraudulent by "clear and convincing evidence."

We find that the court's instructions were not in accord with New York law. The fidelity bonds issued by Reliance cover losses resulting from either "dishonest or fraudulent" acts. Under New York law, the standard of proof required to prove a fraudulent act differs from that required to prove a dishonest act. Fraud must be proven under the higher "clear and convincing" evidence standard. *Hutt v. Lumbermens Mutual Casualty Company*, 95 A.D.2d 255, 466 N.Y.S.2d 28 (2d Dep't 1983). Dishonesty, however, need be proven merely by a "preponderance of the evidence." *Sutro Bros. & Co. v. Indemnity Ins. Co. of North America*, 264 F. Supp. 273, 282 (S.D.N.Y.), *aff'd*, 386 F.2d 798 (2d Cir. 1967) (in the case of a blanket bond indemnifying brokers against any loss of property through common law or statutory larceny, a preponderance of the evidence is the appropriate standard by which to prove dishonest acts such as common law or statutory larceny, theft, or misrepresentation). *See also Aetna Cas. & Sur. Co. v. Glass*, 75 A.D.2d 786, 428 N.Y.S.2d 246, 247 (1st Dep't 1980) (a preponderance of the evidence is the appropriate standard by which to prove conversion), *and* Appleman, *Insurance Law & Practice*, Vol. 21B, § 12774 at 311-312 (Rev. ed. 1980).

Reliance maintains that the two terms should be construed as synonymous, first, because fraud and dishonesty are always referred to in conjunction with each other; and second, because any other interpretation would mean that an insured would never attempt to prove fraud, since it would be easier to prove dishonesty. They claim that an interpretation attaching different evidentiary standards to the two words would essentially read "fraudulent" out of

the contract because it would be included within the meaning of "dishonesty."

New York law does not, however, consider the words fraud and dishonesty to be synonymous. Dishonesty is broader and may cover acts which fall short of constituting fraud. The evidentiary standards for acts that involve moral turpitude but not fraud is the preponderance of the evidence. *Aetna Cas. & Sur. Co. v. Glass*, *supra*. Even where the acts are intentional offenses, "all that is required is that there be satisfaction of the usual civil rule of proof by a preponderance of the evidence," 13 Couch on Insurance 2d, § 46:86 at 80 (Rev. ed. 1982).

When two or more causes of loss are disjunctively stated in the context of a fidelity bond, it is sufficient that the loss be caused by any one of them. *Fidelity & Casualty Co. v. Blount Plow Works*, 78 Ind. App. 529, 136 N.E. 559 (1922). Thus "a bond indemnifying against loss through fraud, dishonesty, forgery, theft, embezzlement, or wrongful abstraction, is not confined exclusively to loss from dishonest acts." 13 Couch on Insurance 2d, § 46:44 at 49, citing *Fidelity & Casualty Co.*, *supra*. It follows that for each cause of loss stated in a fidelity bond, a separate burden of proof attaches. The court thus should have accorded the preponderance burden to the term dishonesty and distinguished it from the higher burden applicable to fraud.

We find, however, that, in view of the evidence at trial, the error in the court's charge was harmless. As Reliance argues, the record fails to show that Helmke committed any acts of dishonesty with the "manifest intent" either "to cause the insured to sustain [a] loss" and "to obtain financial benefit" for himself or for others even under the preponderance of the evidence standard. We find that

Reliance has met its burden of showing that the error made no difference.

In the 1970s, prior to Helmke's becoming head of the mortgage loan department, the real estate market was depressed, and many of Leucadia's loans were in default. In several cases the amount of the loans outstanding exceeded the value of the real estate securing them. Leucadia was repeatedly in upheaval, undergoing four major changes of management in less than fifteen years. Leucadia's losses were therefore due in part to the depressed market conditions, in part to Leucadia's internal disorganization, and in part to the mismanagement of its accounts and its failure properly to supervise its employees.

Furthermore, there is no evidence Helmke intended to benefit himself or others by continuing to advance money to borrowers in arrears.

Almost all of Helmke's decisions to advance moneys which ultimately resulted in losses can be construed to be reasonable under all the circumstances. Almost all were subject to the approval of other Leucadia officials and most of them were expressly approved.

Leucadia had a credit agreement with a consortium of about 125 banks whereby the banks would lend Leucadia money so long as the company's net worth remained above a certain level. A foreclosure of mortgages on realty would have adversely affected Leucadia's net worth. In this context the loans Helmke made may plausibly be viewed as an attempt to keep properties afloat and to preserve the existing collateral in order to prevent difficulties for Leucadia under the credit agreement.

Franklin Johnson, a member of Leucadia's board of directors and a consultant to the firm since early 1976, tes-

tified that, in view of the depressed real estate market in the 1970s, renovation of properties was critical in order to save Leucadia from breaching its credit agreement with the banks. Foreclosures would reduce Leucadia's ability to maintain its credit. Thomas Mara testified that it was not contrary to company policy to enhance the value of collateral held by the company in troubled accounts. Indeed, there was evidence that the practice continued even after Helmke's tenure.

The most questionable of Helmke's actions vis-a-vis Silverman was his knowing misrepresentation to his superiors that the amount of collateral available for the Grand White loan on Silverman's account was $1.3 to $2 million more than it was. This misrepresentation falls short of meeting the test of dishonesty in the fidelity bonds since there was no manifest intent to benefit Silverman at Leucadia's expense. At worst, Helmke misled his superiors in order to get approval for a loan he thought necessary to save the property.

Leucadia's other allegations of Helmke's misconduct concerning Silverman—such as writing the latter a check to induce him to settle the IBM case without notifying his superiors—are less egregious and, although they may be violative of company policy, can reasonably be explained as attempts to save properties in default.

William Healey, Helmke's predecessor as head of the mortgage loan department, testified that the Silverman properties had to be kept afloat to await better times, which Helmke and others felt were coming. This faith in the ultimate value of the properties was vindicated. The real estate market began to improve in 1978, and after Silverman went into bankruptcy on December 23, 1977, Leucadia foreclosed and sold all of his properties in its

portfolio. Between 1978 and 1982, Leucadia recovered almost $4.6 million as a result of these sales and thus suffered no net loss on Silverman's account.

Nor does the record show any dishonest acts by Helmke concerning the Duddlesten loans. There is no evidence that the money was improperly advanced prior to the bond period; for these advances Helmke had the approval of Leucadia's senior credit committee. His representation to the senior credit committee that the Seamist loan would be cross-collateralized, when, in fact, it was not, appeared to be an expectation which was not realized, made without any intent to deceive or defraud Leucadia.

As to the deal Helmke struck with Duddlesten during the bond period, in which he returned the latter's personal guaranties in exchange for a deed on 708 acres, this appears to have been part of an arrangement whereby Helmke was trying to avoid any claim of usury. Leucadia had experienced difficulties with Texas usury law in the past and stood to lose its claim to the properties which collateralized the Duddlesten loans as well as its principal and interest. It therefore seemed reasonable to give up personal guaranties which, according to Thomas Mara, Leucadia never had any intention of enforcing.

Furthermore, Duddlesten had threatened to file a lien to substantiate his option to purchase Main 2016, one of the properties Leucadia had been trying to sell. Helmke's settlement was a means of avoiding this outcome and was a reasonable way of promoting Leucadia's interests. Helmke was negotiating in a situation where Leucadia had little leverage and much to lose; but there is no evidence of dishonesty.

With respect to the Suson loans, Helmke cannot reasonably be blamed for Leucadia's loss. This loss was due to

forgeries perpetrated by Suson. The forgery put Leucadia in a position of having to take less money and having to reach a settlement with the company insuring the loans in order to avoid incurring a greater loss. Nor is there any evidence that Helmke knew about Suson's forgery or connived with him to conceal it at Leucadia's expense. Rather, he initiated the investigations that eventually uncovered the suspected fraud. In fact, these investigations ultimately resulted in settlement proceedings from which Leucadia received $9,150,000 after Helmke's termination.

The fact that Helmke became a director at one of the companies Silverman controlled six weeks after he was terminated in September 1977 does not show that his advances to Silverman since 1975 had been made with an intent to benefit himself at Leucadia's expense. It is common for business relationships to develop in such a way that they result in the employment of one party by the other.

In sum, we are convinced beyond a reasonable doubt that the jury would not have found that there was a preponderance of the evidence to show that, during the bond period, Helmke had committed any dishonest acts which caused a loss to Leucadia.

Affirmed.

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

At a stated Term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse in the City of New York, on the 18th day of January, one thousand nine hundred and eighty-nine.

PRESENT:

HONORABLE J. EDWARD LUMBARD,
HONORABLE ROGER J. MINER
Circuit Judges,

HONORABLE WILLIAM C. CONNER,
*District Judge.**

LEUCADIA, INC.,

Plaintiff-Appellant,

-against-

RELIANCE INSURANCE COMPANY,

Defendant-Third-Party Plaintiff-Appellee,

-against-

EDWARD H. HELMKE,

Third-Party Defendant.

---

* The Honorable William C. Conner, Senior United States District Judge for the Southern District of New York, sitting by designation.

A petition for rehearing having been filed herein by counsel for plaintiff-appellant,

Upon consideration thereof, it is denied.

IT IS FURTHER ORDERED that our decision dated December 22, 1988 be amended as follows to conform with Boyle v. United Technologies Corporation, _____ U.S. _____, 108 S. Ct. 2510, June 1988:

Page 7190, lines 20-21:

Replace ". . .beyond a reasonable doubt that the jury would nevertheless have found. . ." with "that no reasonable jury could have found. . ."

Page 7209, lines 20-21:

Replace ". . .the jury would not have found. . ." with "no reasonable jury could have found. . ."

SO ORDERED.

J. EDWARD LUMBARD, U.S.C.J.

ROGER J. MINER, U.S.C.J.

WILLIAM C. CONNER, U.S.D.J.
Sitting by Designation

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

No. 1333 — August Term 1987

Argued: June 13, 1988 Decided: December 22, 1988

Docket No. 88-7197

LEUCADIA, INC.,

Plaintiff-Appellant,

-against-

RELIANCE INSURANCE COMPANY,

Defendant-Third-Party Plaintiff-Appellee,

-against-

EDWARD H. HELMKE,

Third-Party Defendant.

Before:

LUMBARD, MINER, *Circuit Judges*, and
CONNER, *District Judge*.*

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* The Honorable William C. Conner, Senior United States District Judge for the Southern District of New York, sitting by designation.

ERRATA

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So Ordered:

J. EDWARD LUMBARD
U. S. Circuit Judge

2/9/89
Date

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

At a stated Term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse in the City of New York, on the 22nd day of December, one thousand nine hundred and Eighty-Eight.

PRESENT:

HON. J. EDWARD LUMBARD,

HON. ROGER J. MINER

HON. WILLIAM C. CONNER, DISTRICT JUDGE*

Circuit Judges,

88-7197

LEUCADIA INCORPORATED,

Plaintiff-Appellant,

V.

RELIANCE INSURANCE COMPANY,

Defendant-Third-Party Plaintiff-Appellee,

V.

EDWARD H. HELMKE,

Third-Party Defendant.

Appeal from the United States District Court for the Southern District of New York

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged and decreed that the judgment of said District Court be and it hereby is affirmed in accordance with the opinion of this court with costs to be taxed against the appellant.

Elaine B. Goldsmith
Clerk

Edward J. Guardaro
Deputy Clerk

A TRUE COPY
ELAINE B. GOLDSMITH, Clerk
By Friden Cassidy
Deputy Clerk

ISSUED AS MANDATE: Feb. 9, 1989

88 No. 1704

Supreme Court, U.S.
FILED
MAY 18 1989
JOSEPH F. SPANIOL, JR.
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In The

Supreme Court of the United States

October Term, 1988

LEUCADIA, INC.,

Petitioner,

vs.

RELIANCE INSURANCE COMPANY,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

RESPONDENT'S BRIEF IN OPPOSITION

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14 pp

QUESTION PRESENTED

Should this Court grant certiorari on the question of whether an asserted error in jury instructions may be held harmless, where petitioner's claim under two fidelity bonds that respondent's principal committed acts of dishonesty and fraud in performing his duties as petitioner's employee, was without evidentiary support and did not rise to the level of proffering a credibility issue for the jury to determine, to the point where the action should have been dismissed prior to its submission to the jury?

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In The

Supreme Court of the United States

October Term, 1988

LEUCADIA, INC.,

Petitioner,

vs.

RELIANCE INSURANCE COMPANY,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

BRIEF IN OPPOSITION

STATEMENT OF THE CASE

Petitioner Leucadia, Inc. ("Leucadia") presents a garden variety failure of a plaintiff to establish the elements of a *prima facia* case, suggesting that issues of credibility are at stake. The reality is that despite a gargantuan crusade on Leucadia's part that exacted a tremendous toll on the courts and the parties over

the course of eight years of discovery and a trial lasting almost four weeks, Leucadia did not even come close to meeting its burden of proof by any standard. The attempt to transmute its own egregious failure of proof into a judicial lapse of constitutional proportions is but a desperate, last ditch gambit to revive a moribund claim. As the Court of Appeals held unanimously, this lawsuit was destined for failure as a matter of law regardless of the niceties of the jury charge that the Court employed.

Leucadia lodged a claim for recovery under two fidelity bonds issued by the respondent Reliance Insurance Company ("Reliance"). The claim asserted that Reliance's principal, Edward Helmke ("Helmke") committed dishonest or fraudulent acts while in petitioner's employ as head of its mortgage loan department.

The bonds at issue contain the following language:

> Dishonest or fraudulent acts as used in this insuring agreement shall mean only dishonest or fraudulent acts committed by such employee with the manifest intent:
>
> a. to cause the insured to sustain such loss; and
>
> b. to obtain financial benefit for the employee.
>
> or for any other person or organization intended by the employee to receive such benefit, other than salaries, commissions, fees, bonuses, promotions, awards, profit sharing, pensions or other employee benefits earned in the normal course of employment.

* * *

> Dishonest or fraudulent acts as used in this Insuring Agreement shall mean only dishonest or fraudulent acts committed by such Employee with the manifest intent:
>
> (a) to cause the Insured to sustain such loss; and
>
> (b) to obtain financial benefit for the Employee, or for any other person or organization intended by the Employee to receive such benefit. . .

Leucadia's claim of fraudulent and dishonest conduct hinged on the sole premise that Helmke made improper loans to three individuals: Silverman, Suson and Duddlesten. The record is clear, however, that in each instance, the transactions were not dishonest or fraudulent acts within the meaning of the bonds. They were consistent with Leucadia's own objectives to maintain values on real estate mortgage holdings and thereby to prevent a default under the credit agreement with a consortium of banks by which Leucadia was bound to maintain a significant net worth. They were also approved by Helmke's superiors and otherwise sanctioned by Leucadia's own policies and business interests as they were then being implemented by Leucadia's own business organization at large.

Leucadia's own witnesses established that Helmke's actions were the same as those taken by his predecessors and successors and that they were largely negotiated and approved by Helmke's superiors. In the case of the Suson loans, for example, the alleged losses were occasioned by forgeries perpetrated by Suson himself in releasing security held by Leucadia to secure certain loans. After the forgeries were discovered, Leucadia compromised the ensuing claim against a title company and thereby generated its own

damages. The loans to Silverman did not cause any loss since the properties securing those loans were sold at ample returns which negated the claimed loss. Helmke's representation to the senior credit committee that one of the Duddlesten loans would be secured by a security interest in Duddelsten properties was nothing but "an expectation which was not realized, made without any intent to deceive or defraud Leucadia." (Pet. App. A22).

The Court concluded:

> [T]he record fails to show that Helmke committed any acts of dishonesty with the "manifest intent" either "to cause the insured to sustain (a) loss" and "to obtain financial benefit" for himself or for others even under the preponderance of the evidence standard. We find that Reliance has met its burden of showing that the error made no difference.
>
> * * *
>
> Leucadia's losses were . . . due in part to the depressed market conditions, in part to Leucadia's internal disorganization and in part to the mismanagement of its accounts and its failure properly to supervise its employees.
>
> Furthermore, there is no evidence Helmke intended to benefit himself or others by continuing to advance money to borrowers in arrears. (Pet. App. A19-A20).

The Court summarized its conclusion as follows:

> In sum, we are convinced beyond a reasonable

doubt that no reasonable jury could have found that there was a preponderance of the evidence to show that, during the bond period, Helmke had committed any dishonest acts which caused a loss to Leucadia. (Pet. App. A19, A20, A23, as amended, A25).

Contrary to Leucadia's claim, the Court of Appeals did not appropriate issues of credibility from the jury. Viewed objectively, Helmke's actions were honest. Petitioner's contrary interpretation amounts to speculation and surmise. It was therefore proper for the Court of Appeals to apply a harmless error standard in assessing the impact of the District Court's failure to instruct the jury to apply the preponderance standard to determine if petitioner had met the burden of establishing dishonesty on the part of Helmke.

Indeed, in light of Leucadia's arrant failure of proof as to either element, dishonesty or fraud, the District Court obviously would have been justified to grant Reliance's motion to dismiss the action altogether without submitting it to the jury at all and, indeed, should have done so. The District Court's reluctance to direct a verdict — apparently in light of the substantial investment of judicial resources in the four week trial — is no indication that there was an issue for the jury to determine and hence, no federal constitutional error vis-a-vis Leucadia's right to a jury trial is presented.

REASONS FOR DENYING THE WRIT

I.

THERE IS NO CONSTITUTIONAL OR OTHER INFIRMITY IN THE COURT OF APPEALS' AFFIRMANCE OF THE JUDGMENT SINCE PETITIONER FAILED TO PROVE FRAUD OR DISHONESTY.

Leucadia's attempt to enshroud this diversity action with constitutional importance is truly fallacious. The argument that the Seventh Amendment guarantee of jury trial has been trifled with is misplaced.

Boyle v. United Technologies Corp., ____U.S.____, 108 S. Ct. 2510 (1988), with which the view of the Court of Appeals expressly conforms (Pet. App. A25), itself dispenses with Leucadia's argument. There, it was argued that "since the formulation of the defense adopted by the Court of Appeals differed from the instructions given by the District Court to the jury, the Seventh Amendment guarantee of jury trial required a remand for trial on the new theory." This Court stated:

> We disagree. If the evidence presented in the first trial did not suffice, as a matter of law, to support a jury verdict under the properly formulated defense, judgment could properly be entered for the respondent at once, without a new trial. (*Id.* at 2519.)

Leucadia cites *Liberty National Bank v. Aetna Life & Casualty Company*, 568 F. Supp. 860 (D.N.J. 1983) as a similar case involving an allegedly dishonest employee's fraud. Suffice it to state that *Liberty* is replete with genuine issues of material fact concerning the employee's knowledge of his restricted lending

authority, his falsification of the minutes of board meetings, his deliberate lies and his failure to make various disclosures to his superiors.

It is commonplace that:

> Errors in instructions routinely are ignored if a motion for a directed verdict should have been granted, or if the erroneous instruction went to an issue that is immaterial in the light of the jury's verdict, or if it otherwise is apparent that the error could not have changed the result. (Wright & Miller, Federal Practice and Procedure: Civil § 2886.)

There is no need for this Court to revisit this fundamental and oft-repeated principle: Where a plaintiff-appellant failed to carry its burden of proof, *i.e.*, the state of the evidence is such that a directed verdict against the appealing party would have been proper, an erroneous instruction constitutes harmless error. *Prebble v. Broderick,* 535 F.2d 605 (10th Cir. 1976); *Vecchio v. Anheuser-Bush, Inc.,* 328 F.2d 714, 719 (2d Cir. 1964), *cert. denied,* 379 U.S. 831, 85 S. Ct. 60 (1964). ("Thus, despite the incorrect charge given to the jury when they found for defendant, the judgment entered below for defendant must be affirmed because the lower court should not have submitted the case to the jury at all but should have granted defendant's motion for directed verdict."). *Harris v. Quinones,* 507 F.2d 533 (10th Cir. 1974).

It is well settled, also, that an erroneous instruction dealing with the burden of proof to establish fraud constitutes harmless error where the evidence is insufficient to prove fraud. *L & S Enterprises Co. v. Great American Insurance Co.,* 454 F.2d 457 (7th Cir. 1971). Even an erroneous denial of a jury trial is harmless

error where the evidence is insufficient to establish the elements of a *prima facie* case. *United States v. Williams,* 441 F.2d 637 (5th Cir. 1971). "There is no consitutional right to have twelve men sit idle and functionless in a jury box." *United States v. 243.22 Acres of Land,* 129 F.2d 678, 684 (2d Cir. 1942), *cert. denied,* 317 U.S. 698 (1942).

Indeed, so weak was Leucadia's proof that it must be assumed that the trial court refrained from granting Reliance's motion for a directed verdict, only in deference to the Court of Appeals' admonition in *Konik v. Champlain Valley Physicians Hospital,* 733 F.2d 1007, 1013 n.4 (2d Cir. 1984) and *Mattiui v. South African Marine Corp., "Huguenot",* 618 F.2d 163, 166; n.2 (2d Cir. 1980). In *Konik*, after the trial of an action that consumed nearly four weeks, as did the trial of the present action, the trial judge was admonished that it should have allowed the case to be decided in the first instance by the jury, only for him to set aside the verdict of the jury in the event the jury did not find in favor of the defendant. In this manner, the trial judge can avert a needless retrial in the event the Court of Appeals does not affirm the judgment based upon a directed verdict. Clearly, the trial judge in the present case was unwilling to grant Reliance's motion for a directed verdict only because he was adhering to this recommended practice and not because there was an issue of fact for the jury to decide. Undoubtedly, if the jury verdict would have been in Leucadia's favor, the trial judge would have properly set it aside.

Leucadia would have this Court re-examine facts already scrutinized so carefully by the Court of Appeals below. The arguments tendered for certiorari are without merit. Certiorari should not be granted simply to give Leucadia what will amount to yet another evidentiary appraisal of its stale vendetta against a former employee which has for so long plagued our judiciary.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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